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Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)

Implementation of Sections of)
the Cable Television Consumer)
Protection and Competition Act)
of 1992: Rate Regulation)

and)

Adoption of a Uniform Accounting)
System for Provision of Regulated)
Cable Service)

MM Docket No. 93-215 ✓

CS Docket No. 94-28

COMMENTS OF JONES EDUCATION NETWORKS, INC.

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COMMENTS OF JONES EDUCATION NETWORKS, INC.

Jones Education Networks, Inc. ("JEN") by its attorneys, files its comments in the Commission's Report and Order and Further Notice of Proposed Rulemaking in MM Docket No. 93-215 and CS Docket 94-28.^{1/}

INTRODUCTION

JEN owns and operates Mind Extension University (ME/U): The Education Network, the only 24-hour cable television network solely devoted to education via "distance learning".^{2/} ME/U enables cable subscribers to take

1/ Report and Order and Further Notice of Proposed Rulemaking, MM Docket No. 93-225 and CS Docket No. 94-28, (February 22, 1994) (hereinafter "Further Notice"). These comments address the issue of affiliated transactions raised in the Further Notice.

2/ Jones International, Ltd., JEN's parent, is also the parent of Jones Intercable, Inc. one of the ten largest multiple system operators.

college level courses for credit in their own homes, for which they can ultimately receive undergraduate and graduate degrees from 30 highly respected colleges and universities from all parts of the United States. It also offers pre-college courses and courses that might be taken for self-enrichment on a non-credit basis. Using cable technology, ME/U provides a means for all people to overcome the barriers of cost and access to quality education.

JEN has also announced the creation of three new distance learning services, all of which are intended to further the goals of distance learning and self-enhancement. One of those services, Jones Computer Network, has been operating since May 17, 1993 as a prime-time segment on ME/U. It provides informational and educational programming about computers and digital technologies, to bring computer novices into the information age while keeping computer experts abreast of the most recent digital developments. While continuing to operate as a segment on ME/U, Jones Computer Network will launch as a full-time network on the GE Americom C-3 satellite later this summer.

The other two educational services will follow the same introductory route, appearing first as segments of ME/U before being launched as full-time satellite networks. The Health Network, which will be designed not only to inform audiences on wellness but to provide educational opportunities and certification in health-related fields, will be launched full-time in 1995. The

Language Network, to be focused on foreign language training and international cultural and business matters, will be launched the following year.

All these services will be advertiser-supported. They are all designed to be marketed in the same manner as ME/U -- with low fees to induce cable operators to carry services that are untested and have no brand name recognition. JEN believes that the Commission's proposal which would generally prevent cable-affiliated programmers from pricing their services to their affiliates at prevailing company prices should not be adopted because it would seriously damage the vitality of the cable programming industry without achieving any benefit to consumers.

**I. Adoption of a Higher Threshold to Determine when
Prevailing Company Pricing Can Be Used is Not Necessary.**

In its First Order on Reconsideration^{3/} the Commission adopted rules for affiliate transactions which prescribe the manner in which cable operators must adjust benchmark/price cap rates attributable to affiliated programming costs. The Commission was concerned that cable operators might agree to purchase programming from affiliated programmers at artificially high prices to enable them to charge higher rates. Therefore, the Commission ruled that programming cost pass-throughs would, in the case of affiliated programming, be based on the permissible price charged by the programmer to unaffiliated entities for the same or similar programming. If the programmer has not sold its

^{3/} First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, MM Docket No. 92-266 (August 27, 1993).

programming to a substantial number of unaffiliated entities, the cost to an affiliated operator would be deemed to be the lower of net book cost or estimated fair market value.

The "prevailing price" approach is a reasonable way to deal with any potential abuse by affiliated cable operators and programmers. The Commission, however, in the Further Notice proposes to limit the application of this approach to programmers whose "predominant purpose" is to serve nonaffiliated companies. As a threshold matter, programmers would be deemed to have such a predominant purpose only where they sell more than 75 percent of their programming to non-affiliates. A cable operator that purchased programming from an affiliated programmer that sold less than 75 percent of its product to non-affiliates would be required to determine the cost of the programming on the basis of lower book value or estimated fair market value rather than the price charged to unaffiliated operators.

This rule embodies an unreasonable assumption that a programmer would charge almost three-quarters of its customers artificially high rates merely in order to enable an affiliated cable operator to pass through a higher rate increase. Cable-affiliated programmers need to expand the distribution of their services to as many outlets as possible. Thus, it is highly unlikely that these programmers, regardless of the numbers of nonaffiliated or affiliated operators which are served, will seek to provide their services to affiliated operators to the exclusion of non-affiliates or to price their services to non-affiliates above what

would normally be the prevailing company price. The more fitting presumption, which is amply demonstrated by the widespread distribution of affiliated cable programming services to non-affiliated operators, is that a cable-affiliated programmer will attempt to obtain the widest possible distribution of its product in the marketplace, and this distribution will be at prevailing company prices to affiliates and non-affiliates alike.

The Commission appears to base its tentative conclusions on its experience regulating the telephone industry and its belief that companies that are able to pass on increases in their costs to ratepayers may be motivated to pay excessive amounts for assets obtained from their nonregulated affiliates. However appealing this principle may be in theory, it is simply not applicable to affiliated programming transactions in the cable television industry. The history of the development of the cable television programming industry illustrates that there is no incentive for programmers to charge higher than market prices to their cable affiliates. Rather, they have every incentive to maintain low prices to increase distribution of their services. In any event, it is certainly in the cable-affiliated programmer's interests to sell programming to as many nonaffiliated cable operators as possible to maximize revenues by spreading costs over a wider customer base. The Commission's concern that affiliated programmers would attempt to limit the sale of their services to their affiliated customer base, and thereby extract higher than prevailing company rates is also unfounded. In fact, the Commission in its Report and Order anticipated that "affiliate transactions

will usually be set at the prevailing company price because the record indicates that affiliate transactions in the cable industry primarily involve purchases from affiliated programmers who sell the same products to third parties."^{4/}

Today, cable-affiliated programmers are competing in a highly competitive environment. Indeed, many advertiser supported networks have concluded that the only means to secure cable carriage is to initially offer their program services without a licensing fee. It is obviously in the best interests of programmers to maximize the distribution of their services, and this is especially the case for advertiser supported networks. Moreover, because the video programming marketplace is highly competitive, there is little likelihood that a cable-affiliated program service would attempt to charge higher rates to non-affiliated operators than the marketplace would otherwise allow in order to reap higher license fees from its affiliated systems.

The record contains no evidence indicating that affiliated programmers set out to price their services at other than what would be prevailing company prices, and there are strong competitive incentives which not only dissuade the pricing of services at other than prevailing company prices, but make it desirable to price services low. Given these incentives to maintain low rates and not to seek to extract greater profits than the marketplace will support, there is no reason based on the record developed thus far that would suggest that the

^{4/} Further Notice at ¶ 265.

Commission should revise the substantial third party test and substitute in its place the proposed standard.

**II. A Net Book Cost Test is an Inappropriate
 Cost Indicator for the Programming Industry.**

The Commission's unduly limited definition of when a program service "predominantly serves" affiliated entities is particularly unfortunate, because the alternative test that would be applied to affiliated programming -- "net book value" -- is wholly inappropriate and grossly understates the value of the programming. Application of this test on a widespread basis will diminish any incentive that cable operators may have to invest in and produce their own programming services.

One of the goals of the 1992 Cable Act is to make video programming, much of it created by cable-affiliated programmers, widely available to video distributors.^{5/} If cable-affiliated programmers are not able to achieve a satisfactory rate of return which is comparable to that achieved by non-affiliated programmers, one of the incentives for cable-affiliated programmers to create new programming will be eliminated, and one of the major sources of programming that has heretofore been available to video distributors will be diminished. This is not reasonable when there is no evidence that affiliated programmers have abused their position, or that the present standard of determining the cost of affiliated

^{5/} Cable Television Consumer Protection and Competition Act of 1992, Pub. L. 102-385 § 2(b)(1) (reprinted as a note at 47 U.S.C. § 521).

program services through prevailing company pricing has not proven to be inadequate.

The Commission's proposed 75 percent threshold standard, coupled with its requirement that affiliated programming be priced at the lower of net book cost or estimated fair market value, will not serve the public interest because they will discourage affiliated programmers from investing in new programming services if programmers will not be able to receive a fair return on their investments. The adoption of the proposed standard ignores the dynamics of the cable programming market and the instrumental role that the cable industry has played in its development. The vertical relationship between affiliated operators and programmers lends itself to the creation of innovative programming and promotes program diversity.^{6/} Operator investment in new -- and sometimes foundering -- programming services has created the greatest expansion in programming diversity in television's history.^{7/} Rules that limit operator incentives to invest in such services will halt this growth.

The Commission's treatment of costs for cable-affiliated programming must be sensitive to the nature of the programming business. In

^{6/} Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992 -- Horizontal and Vertical Ownership Limits, Second Report and Order, 8 FCC Rcd 8565, MM Docket No. 92-264, rel. Oct. 22, 1993, at ¶ 7.

^{7/} For example, the Discovery Channel and BET are examples of foundering programming networks that have been rescued by MSO investment. JEN's existing and proposed services exemplify the innovation and diversity in the programming marketplace which continues today.

traditional terms, a programmer does not always have significant capital. Much of the cost of producing, obtaining and airing programming, for instance, may consist of items that traditionally are expended, such as salaries paid to on air talent or production personnel. The ratio of capital costs to expenses, as those terms are traditionally defined, for a programmer may be much lower than for traditional utilities such as telephone companies.

As a result, application of traditional rate of return principles to programming costs is likely to lead to absurd results. If 95 percent of the cost of providing programming is non-capital in nature, an 11.25 percent return on capital means that the programmer is entitled to a margin of less than six tenths of a percent on its total costs. In a business as risky as programming, that clearly is an unacceptable profit margin and will, at best, result in programmers avoiding carriage on affiliated cable systems. More likely, the supply of programming will be greatly reduced for all cable operators.

The Commission can remedy this problem by adopting a more reasonable approach to setting permitted returns for affiliated programming where the prevailing company pricing test is not appropriate.^{8/} Rather than basing the return on the capital base, the Commission should use the overall cost of providing the service as the basis for calculating the permitted return. Modifying the permitted return in this way will restrain programmers from

^{8/} As described above, the Commission also should reduce the scope of the problem by modifying its presumptions regarding when a cable operator is permitted to pay the prevailing company price for affiliated programming.

charging unreasonably high rates to affiliated cable operators while providing the programmers with sufficient incentive to produce and distribute high quality programming to all of the cable customers they serve.

**III. The Commission Should Establish a
 Window for New Programming Services.**

Rather than adopting stricter standards, the Commission should adopt a transition window for new cable-affiliated program services until they have had an opportunity to market their services to a substantial number of third parties. For new services, the Commission should adopt the presumption that the price that is paid for programming by affiliated systems comports with the prevailing company price that has been established by the programmer where the programmer is marketing the service to non-affiliated operators. This presumption should prevail for two years. At the end of this period, if the programmer is not able to sell the service to a substantial number of non-affiliated customers, then an alternative costing test would then be applicable. Even then, however, the operator should have the ability to demonstrate that the service, although not sold to a substantial number of parties, is priced at its estimated fair market value. Absent that showing, the basis for calculating the return should be priced at a programmer's overall cost of providing the service rather than the programmer's net book cost.

CONCLUSION

For the foregoing reasons, the Commission should not modify its current standard under which cable-affiliated programmers may sell their programming to affiliates at prevailing company prices. Additionally, the Commission should establish a transition window which would permit the pricing of new services at prevailing company prices for a two-year period. These measures will ensure the continuation of a vibrant video services marketplace.

Respectfully submitted,

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